John Gapper: Search engines are not the only sites

When George Reyes, Google's finance director, invoked the law of large numbers last week to explain why its revenue growth would slow, he briefly knocked 13 per cent off its market value. But Google and other search engines have more to fear from their reliance on a small number.

Search dominates advertising on the internet. The typical internet advertisement used to be a pop-up that got irritatingly in the way of what you were trying to read. It is now a snippet of text displayed on a search engine, linked to what you are searching for. Such advertisements account for 40 per cent of internet advertising revenues – double the percentage on display ads.

There are reasons for this. Search advertisements are more efficient than display adverts in, for example, glossy magazines. The user often signals a direct interest in buying something, perhaps by typing "flowers" as a search keyword. And the advertiser only has to pay for the advertisement when the user is actually interested enough to click on it.

Search engines are also popular sites with a lot of traffic because people go there to find other things. In ratings vernacular, they have very high "reach" – a lot of people visit them at least a little. Of the 171m people in the US using the internet in January, 146m visited a search engine at least once, according to ComScore Media Metrix, a research group.

But, looked at another way, the search engines run by Google, Yahoo and MSN have a weirdly high share of internet advertising. Most people spend 95 per cent of their time on the internet doing other things than searching. They read news and entertainment sites, send e-mail or instant messages, blog about their beliefs or even display indecent photographs of themselves.

So 5 per cent is the number that Google, Yahoo and Microsoft's MSN Search should worry about: the amount of internet time devoted to searching. Perhaps it is even lower, since a lot of searches are so broad and unconnected with any impulse to spend money that no one will buy a linked advertisement. Whatever it is, an awful lot of advertising revenue flows from a single digit.

Advertising does not work this way in other forms of media. On television and radio and in newspapers and magazines, adverts are sold according to ratings and circulation. This means the number of people who read each edition of a magazine, or who view each showing of a programme. Publishers and broadcasters gain advertising by offering the chance to reach these people in a block.

If internet advertising followed suit, revenues would not be concentrated overwhelmingly on a small portion of internet traffic, but spread more evenly. In practice, however, it is hard to find sites with enough traffic (and therefore advertising potential) to attract large blocks of advertising. There is fierce competition to place brand advertisements on the few that do exist, such as the home pages of Yahoo or AOL.com.

The internet's fractured nature brings a second problem for smaller sites. A publisher knows a lot about the profiles and interests of those who buy its magazines and can use this information to attract advertisers. But it may know little about those reading an article in an online publication because many have clicked through on impulse from other sites and stay only long enough to finish it.

The advertising gulch between search engines and the rest of the internet has so far played into the hands of companies such as Google and Yahoo. But their strength could become a vulnerability if other sites and publishers find a way to redress the imbalance by selecting their own advertisements more effectively.

One method of doing so is that is attracting interest among advertisers and publishers is so-called behavioural targeting. This involves an internet user being shown advertisements that are likely to interest them, no matter which site they happen to be browsing at the time. The same BMW advert might appear whether they are looking at a car on a specialist review site. In others, advertisers log which articles users click on and either use this data to display relevant adverts or share it with others in return for a cut of their advertising revenues.

These are early days for behavioural targeting and it could yet fall foul of everything from privacy concerns to the inability of smaller sites to work together. Yet it creates the possibility of a challenge to the dominance of big search engines. (The Financial Times is among companies that have struck deals with behavioural targeting agencies such as Revenue Science, AlmondNet and Tacoda.)

Of course, Google and others will not stand idly by while the techniques they use to scoop up most advertising on the internet are adopted by others. Eric Schmidt, Google's chief executive, reassured investors last week that it intended to extend its dominance in advertising to the rest of the internet, as well as to print and radio.

But can search engines maintain a 40 per cent share of advertising on a 5 per cent share of internet viewing indefinitely? That seems unlikely, no matter how smart their engineers and how valuable the signals their users send. As Mr Reyes bluntly indicated, Google and its peers have already made their easiest money.